Internal Revenue Service

Department of the Treasury

Washington, DC 20224

881.02-00, 7701.01-00, 895.00-00,
988.04-00,863.03-00,865.01-00
Third Party Communication,
October 14, 1998, Other Government Agency

Person to Contact:

Telephone Number:

199911051

Refer Reply To:
CC:INTL:Br5: PLR 114198-98
Date:
December 18, 1998

Third Party Communication,
October 14, 1998, Other Government
Agency

TY: 1999

Taxpayer	=
Area Y	=
Organization X	=
Treaty X	=
System X	=

This is in reply to your letter dated July 1, 1998, requesting rulings under sections 895 881, 988, 863 and 865 of the Internal Revenue Code. Additional information and representations were submitted in letters dated October 6, 1998, and December 17, 1998.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for ruling, it is subject to verification upon examination.

Several countries in Area Y have entered into Treaty X, which established Organization X. The objectives of Organization X include, inter alia, the promotion of economic and social progress which is balanced and sustainable, implementation of a common foreign and security policy, strengthening of the protection of the rights and interests of the nationals of its member countries and development of cooperation on justice and home affairs. In furtherance of the economic goals of Organization X, Treaty X provides for the establishment of System X, a system of central banks composed of Taxpayer and the national central banks of the member countries of Organization X. Treaty X also provides for the creation of a common monetary unit and provides Taxpayer with the exclusive power to issue currency common to the participating

member countries of Organization X.

Taxpayer was established pursuant to Treaty X as a separate entity and possesses full legal rights under the laws of the member countries of Organization X. Taxpayer's shareholders are the central banks of the member countries of Organization X. Taxpayer's shareholders have no personal liability for the debt of or claims against Taxpayer by reason of being shareholders of Taxpayer.

Taxpayer has the exclusive right to authorize the issue of banknotes for the participating member countries of Organization X. Taxpayer plays an integral role in monetary policy, oversees financial institutions and represents Organization X in dealings with other sovereigns and third parties. Taxpayer determines the calculation of minimum credit reserves for banking institutions operating in member countries and ensures the efficient and sound clearing and payment systems within Organization X. Taxpayer has authority to open accounts for market participants and accept assets. Taxpayer has full authority to hold and manage foreign reserves that are transferred to it and use such funds for purposes set out in Treaty X. Taxpayer may buy and sell marketable instruments and currencies and establish relationships with central banks and financial institutions in other countries in order to achieve the objectives set forth under Treaty X.

Taxpayer will be provided with foreign reserve assets by the national central banks of the member countries of Organization X. In the course of managing these reserves, Taxpayer may enter into repurchase agreements, purchase and sale of securities, securities lending operations, foreign exchange transactions, foreign exchange swaps, interest rate futures, interest rate swaps and currency options.

Taxpayer may conduct the above described transactions with counterparties located in the United States. Such transactions would be entered into between the U.S. counterparties and the dealing rooms of the national central banks of participating member countries who will act as the Taxpayer's agent for this purpose. None of the dealing rooms through which the Taxpayer's foreign operations will be conducted are located in the United States. Taxpayer will not employ dependent agents in the United States. Further, Taxpayer does not have an office in the U.S. through which the activities described above are conducted.

Requested Ruling 1

Section 895 of the Code provides, in part, that income derived by a foreign central bank of issue from obligations of the United States or any other agency or instrumentality thereof that are owned by such foreign central bank of issue, or derived from interest on deposits with persons carrying on the banking business, shall not be included in gross income and shall be exempt from taxation. However, section 895 provides further that

such income will not be exempt from taxation if such obligations or deposits are held for, or used in connection with, the conduct of commercial banking functions or other commercial activities.

Section 1.895-1(b)(1) of the regulations defines a "foreign central bank of issue" as a bank which is by law or government sanction the principal authority, other than the government itself, issuing instruments intended to circulate as currency. The regulations indicate that such a bank generally is the custodian of the banking reserves of its country. Section 1.895-1(b) also provides that the exclusion granted by section 895 applies to an instrumentality separate from a foreign government, whether or not wholly owned by a foreign government. The regulations further state, as an example, that "foreign banks organized along the lines of, and performing functions similar to, the Federal Reserve System, qualify as foreign central banks" for purposes of section 895 of the Code.

Pursuant to Treaty X, Taxpayer is intended to be the principal authority issuing instruments for circulation as currency for the participating member countries of Organization X and is the custodian of the reserves of Organization X. Accordingly, Taxpayer is considered to be a central bank of issue within the meaning of section 1.895-1(b) of the regulations. Therefore, for purposes of section 895 of the Code, income derived by Taxpayer from obligations of the United States (or of any agency or instrumentality thereof) which are owned by Taxpayer within the meaning of section 1.895-1(c), or from interest on deposits with persons carrying on a banking business shall be excluded from gross income and exempt from taxation, provided such obligations or deposits are not held for, or used in connection, with the conduct of commercial banking functions or other commercial activities.

No opinion is expressed as to whether Taxpayer is engaged in a commercial banking function or other commercial activities, as defined in section 1.895-1(d) of the Regulations.

Requested Ruling 2

Sections 7701(a)(4) and (5) of the Code define a foreign corporation as a corporation that is not created or organized in the United States or under the laws of the United States or of any State.

Section 301.7701-2(a) of the Procedure and Administration Regulations provides that business entities are entities recognized for federal tax purposes that are not properly classified as trusts under § 301.7701-4 or otherwise subject to special treatment under the Code. A business entity with two or more members is classified for federal tax purposes as either a partnership or a corporation. For federal tax purposes, the term "corporation" includes associations (as determined under § 301.7701-3). Section

301.7701-2(b)(2).

Under section 301.7701-3(a), a business that is not classified as a corporation under section 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) is an eligible entity that can elect its classification for federal tax purposes. A foreign eligible entity that does not file an election is an association if all of its members have limited liability.

Taxpayer is a foreign eligible entity in which all the members have limited liability that has not filed an election under § 301.7701-3 to be taxed as a partnership. Therefore, it is a foreign association under § 301.7701-3(b) and classified as a foreign corporation for federal tax purposes under § 301.7701-2(b)(2).

Section 881 of the Code imposes in general a tax of 30 percent of the amount received from sources within the United States by a foreign corporation as interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income, but only to the extent the amount so received is not effectively connected with the conduct of a trade or business within the United States.

Section 881(c) of the Code provides an exception to tax for payments that qualify as portfolio interest. In general, portfolio interest is defined to include interest paid on an obligation which is in registered form and with respect to which the withholding agent receives the prescribed statement to the effect that the beneficial owner of the interest is not a U.S. person (and certain obligation not in registered form).

Because Taxpayer is a foreign corporation, pursuant to section 881(c) of the Code, no tax shall be imposed on Taxpayer in the case of portfolio interest received by Taxpayer from sources within the United States (except as otherwise provided in section 881(c)).

Requested Ruling 3

Section 988(a)(3)(A) of the Code provides that the source of foreign currency exchange gain or loss is generally determined by reference to the residence of the taxpayer or the qualified business unit of the taxpayer on whose books the asset, liability, or item of income or expense is properly reflected. Section 988(a)(3)(B)(i)(III) provides that, for purposes of sourcing exchange gain or loss, the residence of a foreign corporation is a country other than the United States.

Taxpayer has represented that it does not have a unit of a trade or business in the United States that maintains separate books and records. Accordingly, any section 988 gain or loss is sourced by reference to Taxpayer's residence. Section 988(a)(3)(A). Since Taxpayer is not a United States person, any section 988 gain or loss is foreign source gain or loss. Section 988(a)(3)(B).

5

CC:INTL:Br5:PLR 114198-98

Requested Ruling 4

Section 1.863-7(b) provides that, in general, the source of notional principal contract income shall be determined by reference to the residence of the taxpayer as determined under section 988(a)(3)(B)(i) of the Code.

Since Taxpayer is resident outside of the United States under section 1.988(a)(3)(B)(i)(III) of the Code, it is held that to the extent notional principal contract income does not arise from the conduct of a U.S. trade or business, it shall be foreign source income pursuant to section 1.863-7.

Requested Ruling 5

Section 865(a)(2) provides that income from the sale of personal property by a nonresident generally shall be sourced outside the United States. Section 865 (g)(1)(B) of the Code provides that the term nonresident means any person other than a United States resident. However, section 865(e)(2) of the Code provides that if a nonresident maintains an office or other fixed place of business in the United States, income from any sale of personal property (including inventory property) attributable to such office or other fixed place of business shall be sourced in the United States.

Taxpayer is nonresident within the meaning of section 865(a) and 865(g)(1)(B). In addition, taxpayer has represented that it has no office or other fixed place of business in the United States. Accordingly, income from the sale of personal property shall be sourced outside the United States in accordance with the provisions of section 865(a)(2) of the Code

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item not discussed or referenced in this letter.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely yours,

Jeffrey Dorfman
Chief, Branch 5
Office of Associate Chief Counsel (International)